COUNTY OF LOS ANGELES

DEPARTMENT OF PUBLIC WORKS

"To Enrich Lives Through Effective and Caring Service"

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TO: Each Supervisor

FROM: Donald L. Wolfe
Director of Public Works

POTENTIAL HURRICANE-RELATED CONSTRUCTION COSTS IMPACTS

The following is to inform you of potential construction cost increases resulting from Hurricanes Katrina and Rita and their impact on both the building capital construction program and the public works infrastructure construction program.

Although the extent of damage from Hurricanes Katrina and Rita has not been fully assessed, the destabilizing impact on construction costs is becoming apparent. Key issues underlying this instability are the disruption of oil production and refining, increased fuel prices resulting in higher transportation and manufacturing costs, disruption of shipping, raw commodities shortages, and increased demand created by the effort to rebuild the affected areas. Until actual pricing trends become clear, construction bids may be inflated reflecting the uncertainty of the price and availability of building materials and labor. Contractors are already reporting difficulty in obtaining subcontractor and material supplier quotes, and most pricing is only valid for very short periods. As further explained in the attached report, we anticipate price increases in virtually every labor and material component of our construction programs.

We will closely track industry and bid trends in the coming months to develop a projection of the construction cost impacts to the County's construction programs. We will provide you with periodic updates as cost data and bid trends emerge. We will also work with the Chief Administrative Office to evaluate cost implications for current and upcoming projects and to develop mitigating strategies where feasible.

If you have any questions or need additional information, please call me or your staff may contact David Howard at (626) 300-2300.

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Attach.

cc: Chief Administrative Office (David Janssen, Jan Takata)

HURRICANE-RELATED CONSTRUCTION COSTS IMPACTS

Assessing the effects from Katrina is a complex process. New information becomes available each day, leading to a revaluation of prior assessments. Underlying any evaluation of the post hurricane construction cost environment is the fact that many construction materials and many types of skilled construction labor were already in short supply due in part to the robust national expansion for housing, continuing high levels of international commodity demand, and instability affecting oil production in the Middle East and Venezuela. Whereas the annual *Engineering News Record 20-City Cost Index* had been projecting a national average of 3 percent for the year since last September, the inflation rates were raised in late September 2005 to 3.4 percent nationally and to 3.9 percent for Los Angeles. This is an estimate of cost increase for the past 12 months and does not directly project future trends. However, indicative of future impacts is Edison International's recent 3 percent upward adjustment of its August 2005 8 percent rate increase request now pending the State Public Utilities Commission's approval. Edison is justifying the revised 11 percent rate increase on the basis that natural gas prices have risen 25 percent since Hurricane Katrina.

The recovery and rebuilding effort will be long and will trend upwards in the next 12 to 18 months. Initial post hurricane demand was immediately evident in pricing increases for petroleum-based products, transportation costs, and sheathing and roofing products. Plywood products, along with gypsum wallboard and trucking costs, will be under increased pressure as emergency modular housing is produced. Materials and skilled labor utilized for heavy construction will come under increased demand as the restoration and reconstruction of major infrastructure commences, including significant highway, port, utility and flood control improvements. As the rebuilding efforts continue, the prices for commercial and residential sector products, especially dimensional lumber, sheathing, insulation products, cement, and structural steel, as well as the labor related to these products is expected to increase.

Following are examples of labor and material components used in the Capital Project Construction Program, which are likely to be affected:

Concrete

Concrete, which is used in flatwork, foundations, and key building structural elements, is likely to be impacted significantly due to continued international pricing pressure and hurricane-related energy, shipping, and transportation impacts. It has been reported that prior to the hurricanes, 32 states experienced spot shortages of concrete. These shortages will be heightened by significant demand increases and the fact that approximately 12 percent of the nation's imported concrete passed through New Orleans and Mobile, Alabama. Furthermore, the cost of concrete is extremely sensitive to energy cost increases both for production and transport.

Oil and Petroleum-based Products

Oil and petroleum-based products are impacted due to disruption of production and refining capacity, increased product demand, and higher transportation and indirect manufacturing costs resulting from increased fuel and energy costs. The demand for asphalt products and coatings has increased significantly in the immediate hurricane recovery period. Prices for asphalt roofing materials and asphalt products utilized for road repair are reported to have already spiked as much as 15 percent post-Katrina. As of September 2005, Public Works has experienced an approximate 50 percent increase in asphalt costs since 2004-05, including initial Katrina-related impacts on market prices. Pricing for polyvinyl chloride products, used for plumbing and conduit, is projected to rise due to anticipated increases in temporary and permanent housing production.

Gypsum Products

Gypsum wallboard products have maintained an annual increase of approximately 12.5 percent nationally for the past 12 months. Major manufacturers have large board plants in the affected area, which require repair and restoration of local utility infrastructure. Although the increase in demand should be particularly felt east of the Rocky Mountains, the extraordinary demand for refurbishing existing damaged structures and for new construction is likely to be felt on the West Coast. Industry is anticipating this peak in 12 to 18 months as restoration funding and activity becomes more widespread.

Steel

Steel prices will increase due to higher demand, raw material shortages, and increased energy and petroleum prices affecting both production and delivery. New Orleans and the devastated gulf ports are significant transfer points for manufactured steel products and for imported scrap metal utilized as raw material by steel mini-mills throughout the nation. This region is also a significant production and storage area for liquid nitrogen, a product that is essential for manufacturing steel. Although the vast majority of residential and smaller commercial buildings restoration will not greatly increase steel demand, major facility and infrastructure restoration will create significant demands for structural steel, rebar, and miscellaneous steel products.

Labor

The New Orleans and Gulf Coast areas had experienced a declining construction labor force over the past years due to relatively low levels of regional growth. The impact of Katrina and Rita on the national construction industry, especially for nonresidential construction, will be highly dependent upon the rate and scale of Federal reconstruction funding. The labor ramp-up could peak approximately 2 years from now. The Vice President of Economic Affairs for McGraw Hill Construction, a major source of construction data, recently stated that "the very real issue of skilled labor shortages could dwarf concerns over materials prices. A rule of thumb holds that construction labor is virtually half of the total cost of a building. That share could rise unless labor shortages can be ameliorated. Because subcontractors are quick to relocate to where the demand is greatest, some analysts fear that if labor converges on the Gulf regions, shortages of skilled workers will develop in other areas of the U.S."

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